

Message Text

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21

ACTION NEA-09

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COME-00 FRB-03 XMB-02 OPIC-03 LAB-04 SIL-01 SAB-01

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C O N F I D E N T I A L TEL AVIV 1580

E.O. 11652: GDS

TAGS: EFIN, IS

SUBJ: GOI ANNOUNCES TAX REFORM PROPOSAL

REF: A. TEL AVIV 1394 AND PREVIOUS

B. TEL AVIV A-200 OF AUGUST 21, 1974

BEGIN UNCLASSIFIED

1. THE BEN SHACHAR COMMITTEE, APPOINTED BY GOI LAST NOVEMBER TO STUDY SYSTEM OF DIRECT TAXES AND RECOMMEND CHANGES, PRESENTED ITS REPORT MARCH 12. FINMIN RABINOWITZ TOLD PRESS THAT RECOMMENDATIONS WILL BE IMPLEMENTED IN THEIR ENTIRETY, IF APPROVED BY KNESSET, AND THAT HE BELIEVED BOTH HISTADRUT AND EMPLOYERS WILL SUPPORT THEM. FINMIN EXPRESSED HOPE SYSTEM COULD BE IMPLEMENTED BY JULY. HE TERMED PROPOSAL VERITABLE REVOLUTION IN ISRAEL'S FISCAL SYSTEM WHICH WOULD OPEN WAY TO REHABILITATION OF ECONOMY. KNESSET FINANCE COMMITTEE CHAIRMAN KARGAM ALSO RECEIVED REPORT AND CALLED IT IMPORTANT CONTRIBUTION TO NATIONAL ECONOMIC POLICY.

2. MAIN ELEMENT IN PROPOSED REFORM IS ELIMINATION EXEMPTION
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FROM TAXATION OF MYRIAD ALLOWANCES SUCH AS COST-OF-LIVING,

OVERTIME, INCENTIVE AND SICK PAY, CAR, TELEPHONE, HOLIDAY, ETC, WHICH HAVE BEEN DEvised TO CIRCUMVENT PRESENT HIGH MARGINAL RATES. UNDER PROPOSAL, FREE TRIPS FOR EL AL AND ZIM EMPLOYEES, FREE ELECTRICITY FOR ELECTRIC COMPANY EMPLOYEES, AND FREE SCHOOLING FOR TEACHERS WOULD ALSO BE SUBJECT TO TAX, BUT EMPLOYER WOULD PAY TAX IN THE INTERIM UNTIL NEW LABOR AGREEMENTS COULD BE REACHED. COMPULSORY LOANS, WHICH ARE NOW COLLECTED AS A QUASI-TAX, WOULD BE ABOLISHED. IN EXCHANGE FOR THIS BROADENING OF TAX BASE, PRESENT HIGH MARGINAL RATES FOR INDIVIDUALS WOULD BE LOWERED. CORPORATE AND CAPITAL GAINS TAXES WOULD ALSO BE LOWERED UNDER PROPOSAL.

3. NET EFFECT PROPOSALS ON GOVERNMENT REVENUES IS ESTIMATED BY COMMITTEE AT 1.5 BILLION ISRAELI POUNDS (IL) ANNUAL REDUCTION, BUT WITH CAVEAT THAT LOSS OF REVENUES FROM COMPULSORY LOANS IS ACTUALLY ONLY ABOUT ONE-HALF OF NOMINAL AMOUNT BECAUSE LOANS MUST BE REPAYED. THUS, IL 1.5 BILLION REVENUE LOSS FROM LOANS IS ACTUALLY EQUIVALENT TO ONLY IL 750 MILLION REVENUE LOSS FROM TAXES. COMMITTEE BELIEVES THAT BETTER TAX COLLECTION WILL MAKE UP THIS LOSS ONCE SYSTEM IN OPERATION. MOREOVER, IMPLEMENTATION OF VALUE-ADDED-TAX IN OCTOBER (PER REF A) SHOULD ALSO INCREASE REVENUES.

4. COMMITTEE ESTIMATED THAT 95 PERCENT TAX PAYERS WOULD NOT HAVE TO PAY MORE TAX THAN CURRENTLY ONCE RECOMMENDATIONS IMPLEMENTED. ONE OBJECTIVE OF REFORM PROPOSALS IS THAT LOWER MARGINAL RATES PROVIDE INCENTIVE FOR INDIVIDUALS TO PERFORM ADDITIONAL WORK, IN CONTRAST TO PRESENT SYSTEM. ADDITIONALLY, PROPOSED TAX SYSTEM WOULD BE LINKED TO CONSUMER PRICE INDEX IN ORDER TO PREVENT EROSION OF DISPOSABLE INCOME AS RESULT INFLATION.

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5. COMMENT: GOI ACTION DEMONSTRATES ITS DETERMINATION TO MOVE AHEAD WITH TAX REFORM. ECONOMIC AND ESPECIALLY SOCIAL EFFECTS OF PROPOSED REFORMS WOULD BE BENEFICIAL AND WOULD SERVE TO DIMINISH DISINCENTIVES FOR ADDITIONAL WORK AND TAX EVASION UNDER PRESENT SYSTEM (PER REF B) HOWEVER, WHETHER GOVT WILL BE CONFIDENTIAL

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SUCCESSFUL IN TAXING ALL FRINGE BENEFITS PRESENTLY EXCLUDED IS ANOTHER QUESTION AND COULD PRECIPITATE A DIFFICULT PERIOD OF LABOR RELATIONS, ESPECIALLY AMONG BETTER ORGANIZED PRESSURE GROUPS. DEGREE OF SUCCESS IN IMPLEMENTING REFORMS WILL BE A GOOD INDICATION OF RABIN GOVT'S ABILITY TO MOVE AHEAD WITH ITS DOMESTIC PROGRAMS.

6. KEY FACTOR WILL BE POSITION OF HISTADRUT. HISTADRUT

LEADERS HAVE EXPRESSED SATISFACTION WITH GENERAL OUTLINE AND GOALS OF REPORT AND RABINOWITZ BELIEVES THEY WILL SUPPORT GOVERNMENT ON ISSUE. HISTADRUT, HOWEVER, HAS NOTED PROBLEM AREAS WITH RESPECT TO ELIMINATING CERTAIN FRINGE BENEFITS FROM TAX FREE STATUS AND INCORPORATION OF COST OF LIVING ALLOWANCE INTO TAXABLE INCOME. IT HAS ESTABLISHED SPECIAL COMMITTEE TO REVIEW IMPACT OF RECOMMENDATIONS ON VARIOUS INCOME GROUPS AND PROBLEMS RESULTING FROM PROPOSED CHANGES IN TAX STATUS OF COST OF LIVING ALLOWANCE AND FRINGE BENEFITS. OFFICIAL POSITION OF HISTADRUT WILL BE SUBJECT OF SPECIAL MEETING OF ITS EXECUTIVE COMMITTEE TO BE CALLED IN NEXT FEW WEEKS. END CONFIDENTIAL.
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